

Testimony of Edward F. Kearney
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Before the House Committee on Government Reform
Subcommittee on Government Management, Finance and Accountability
June 22, 2005

Mr. Chairman:

I am the Managing Partner of Kearney & Company, a CPA firm that provides audit, accounting, and consulting services exclusively to the Federal government. I am joined today by Cornelius Tierney, a Director in our Firm, and the author of most of the books written that cover Federal auditing and accounting. We are pleased to have this opportunity to appear before you and provide you with our perspective on some of the issues confronting Federal financial management. The focus of your Committee's efforts on consolidation, simplification, and streamlining the laws governing financial management is timely, and very much needed.

Federal financial management is a complex and comprehensive issue comprised of several distinct disciplines: accounting, financial controls, computerized support systems, program and asset management and accountability, financial reporting, and independent audits. Over many decades, many well-intentioned laws, and numerous agency rules and regulations, and practices that have evolved, all have contributed to the current state of Federal financial management.

Our experiences support the thesis of the Subcommittee that accounting, financial reporting, performance and strategic asset management, and independent auditing should not and can not be separated from sound internal financial controls if Federal financial management is ever going to improve. In the past year, Kearney & Company conducted a study for the Association of Government Accountants. The study report, published in March 2005, is titled, Audit Federal Financial Controls: Sooner Rather than Later? Time

does not permit more than brief mention of this study assessing current state of Federal internal control and the potential impact of adopting the Sarbanes-Oxley Act to the Federal government. We have separately provided copies of the study report to the Subcommittee for its perusal as appropriate.

Federal financial management is governed today by a series of laws that for years have layered new directives and requirements on agency financial managers. Each law has a unique emphasis, although the overarching goal of all the laws is to ensure fiscal integrity, and to provide accurate reporting on program results. The legislative and regulatory history of many years has resulted in conflicted, diluted, duplicative and mixed messages to agencies about desired financial systems and the underlying systems of internal financial controls. Despite good intentions, implementation and application of desired and effective financial internal controls for the Federal government has lagged.

Parallels to the private sector and best practices are often cited as a basis for each new law. While the gap between these two sectors is narrowing, the complexities of legislative mandates and implementing regulations that impact agency financial managers creates confusion. There are also differences between the Federal government and the private sector. New laws are needed to promote accountability appropriate for Federal agencies, but must do so in a cost effective way.

As a CPA firm, we serve the Federal market as both auditor and accountant. What we see across Federal agencies is an uneven application of the laws and requirements, varying by agency budgets and the skill levels of the financial managers. Practically, the implementation of each new requirement takes years, and may span different administrations in an individual agency. If the requirements exceed the timeframe of an agency's administration, an incoming administration may be inclined to emphasize a new initiative, and the previous initiative remains incomplete. The National Academy of Public Administration (NAPA) has reported in the past, that the average tenure of a Federal appointee at the assistant secretary level and higher was about 18 months. That is the risk to layering requirements, rather than providing a more comprehensive

framework. This type of risk not typically present in the private sector where job tenure of senior executives is considerably longer. Also, requirements may affect agencies differently due to a staggered implementation of the legislation. For example, the Defense Department is today working diligently to prepare auditable financial statements. That is almost 15 years after the initial passage of the CFO Act, and the results are at least several years away. That is the risk of not applying the framework consistently across the government.

The CFO Act required that major agencies' financial statements be audited, and this legislation has had probably the largest impact on financial management in the Federal government. The audit requirement has been extended to all government agencies by the Government Management Reform Act (GMRA) and the Accountability of Tax Dollars Act. The audit concept of "trust but verify" requires each agency to annually have an independent auditor review the results of operations, and ensure that the agency is doing what it needs to do in order to achieve a clean opinion on its financials. In the years following passage of the CFO Act, it became apparent that many agencies lacked the systems and controls to prepare auditable financials. Yet eight years earlier in 1982, the Federal Manager's Financial Integrity Act (FMFIA) was intended to hold Federal managers accountable for their financial management practices and establish sound internal controls in each agency.

Annual self assessments of internal controls over Federal financial reporting, concurrent with the audit of an agency's financial statement, could provide assurance and send a message of confidence to parties external to the agency that someone cares about and pays attention to how Federal monies are committed, spent, applied, recorded and reported. The current guidance by OMB in Circular A-123 does not require a separate opinion on internal controls annually, but may necessitate one in the event that an agency's problems persist.

Consolidation of the laws covering Federal financial management is needed. There are multiple laws that require agency financial statements be audited, and there are multiple

laws covering the systems and controls of agencies. The financial management requirements should be consolidated to ensure that the rules and expectations are clear and concise. Today, there is confusion because of the number of laws, the staggered implementation dates of the laws, and the fragmented responsibilities among agency managers.

The concept of preparing financial statements and having them independently audited is the same practice used in the private sector to ensure accurate and consistent reporting. The Federal government has in the latest pronouncement by the Office of Management and Budget in Circular A-123, which guides implementation of the FMFIA, also adopted an internal control framework which closely parallels the framework used in the private sector. The private sector uses the internal control framework recommended by the Committee of Sponsoring Organizations (COSO). The end result is that each agency must adhere to the principle of preparing auditable financial statements in accordance with essentially the same internal control framework as the private sector. That means all agency managers are responsible for agency internal control. Other directives or legislation concerning financial management, internal controls, or information security as it pertains to the internal control framework can potentially result in overlapping requirements, and necessitate coordination among agency managers.

With respect to Federal financial controls, some Congressional legislative “housecleaning” is needed and has a precedent with respect to Federal financial management. For example, GAO in a report for an earlier Senate Committee on Government Operations noted that by Title III of the Budget and Accounting Procedures Act of 1950 Congress repealed 106 acts or parts of acts which were obsolete or became obsolete when this Act was passed. The Act of 1950 became the “be all and end all” of financial policy, mitigating the need to continually reference, integrate, collate, and reconcile proposed changes to financial management legislation that pre-dated the 1950 Act.

Implementing effective and efficient internal controls and correcting existing weaknesses has a price. Obtaining funding in a timely manner to finance changes and systems improvement is difficult and impedes progress. Responsibility for most of the cost of agency financial management resides in the budgets of the Chief Financial Officer (CFO) or Inspector General (IG). Their budgets are not always synchronized with the agency needs. For example, in the event problems are identified during the audit cycle, funds may not be available to address the problems until the following year. Funding mechanisms such as a levy on each appropriation and/or major agency program to cover the cost of implementing effective internal control and stewardship practices should be considered to ensure that when problems are identified, they are resolved on a timely basis. This approach has the added benefit of conveying to non-financial managers within the Federal government the notion that all managers, not just financial managers share a responsibility for internal controls. All too often, the CFO and the IG are perceived as having sole responsibility for controls at a Federal agency. Perhaps the most important message sent by Sarbanes Oxley to the commercial sector is that internal controls are the responsibility of all managers starting with the Board of Directors and flowing down to line management. Congressional initiatives should make it clear that this Sarbanes Oxley concept applies to the Federal government as well

Federal financial managers must be home grown. Colleges and universities do not teach Federal accounting and auditing, and as a result Federal financial managers must be trained by the Federal government. That means the workforce is smaller, and training must be from within. It also means very little research is done on better ways to perform the financial management functions. The research currently done is performed by a few dedicated volunteers and published by organizations such as the Association of Government Accountants or the American Society of Military Comptrollers. Maybe its time to foster and encourage new demonstration projects that lead to better ways to account and report on agency stewardship. Alternatively, if the Federal government were to adopt more private sector financial management practices, the size of the workforce would increase, and the unique training requirements would decline.

In closing, if the past is prologue, new requirements could be “layered” on top of old. But, the process would be much improved if a new law was passed, e.g., the “*Federal Financial Management Act ...of 2005*,” that superseded overlapping, conflicting, duplicative, obsolete legislation of past years and required government-wide compliance with the single, new policy relating to financial management. Alternatively, OMB could be tasked with consolidating all related laws to eliminate past and future layering.

Thank you, Mr. Chairman, for allowing us to provide our observations on the statutes covering Federal financial management, and our concerns particularly as they relate to the state of federal financial controls.

We would be pleased to answer any questions you may have.